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in the Dominican Republic:
A Stunted Innovation

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Credit programs for the rural poor have emerged in most low income countries (LICs) the past twenty years. Initially this involved installing institutions like credit unions, credit cooperatives, and supervised credit programs that had been successful in high income countries. Only a few of these institutional transplants, however, have taken root and flowered. As a result, financial innovations have recently emerged in low income countries that attempt to improve the access of the rural poor to financial services.[1/] These include door-to-door collection of savings deposits by commercial banks, low cost rural bank branches, mobile banks, area development programs with credit as part of a package of services, blanket credit programs that lend to a large proportion of the rural poor in

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1/ Innovations are used here to indicate any change in operations of the financial intermediary. The innovation may be either cost decreasing or cost increasing for the intermediary and/or society.

an area, and group lending. While many of these innovations appear to be very promising when initiated, most do not mature beyond the pilot project phase. Often, within several years of initiation, the aims of the innovation are not met, policymakers become frustrated, and the pilot project is abandoned or the original objectives of serving the rural poor are ignored. One must expect attrition in innovations, but the failure rate in rural financial markets is disturbingly high.

We suggest in the following discussion one explanation for why financial market innovations fail and illustrate our argument with information drawn from a study of group lending in the Dominican Republic. Our aim is to identify factors that have limited the success of a promising group lending program and draw conclusions that may be useful in a number of other low income countries experimenting with loans to groups. We will argue that innovations like group lending end up stunted or abort because of national policies that make it very difficult for cost decreasing financial market innovations to flourish.

Financial Services for the Rural Poor

Serving the rural poor is the most difficult and costly thing that formal financial markets do. Typically, the rural poor are geographically scattered, have unsatisfactory loan collateral, borrow and save small amounts irregularly, do not have established credit ratings with formal lenders, and have low and often unstable incomes that make estimation of repayment capacities difficult for formal lenders. The variations in loan demand make it awkward for formal lenders to manage their loanable funds when they only lend to the rural poor. Permissive attitudes among politicians toward loan repayment may also make it difficult for lenders to press for repayment. Added to these problems, in some cases policymakers force lenders to provide expensive technical assistance to small borrowers, and at the same time require lenders to charge concessionary interest rates. In most LICs the expected net returns from lending to the rural poor are negative for most formal lenders.

Innovators in a number of countries have hoped that grouping would make lending to the rural poor more attractive to formal lenders (Adams and Ladman). At least four advantages are claimed for lending to groups instead of individuals: (1) lenders are able to reduce their loan transaction costs by making one loan to a group rather than making a number of small individual loans, (2) when individuals are jointly liable for the group loan, lenders may be able to reduce loan default and the costs of collecting delinquent loans, (3) lenders may also reduce the costs of providing services like technical assistance by working with groups rather than with individuals, and (4) group loans may reduce the borrower's loan transaction costs and make formal loans and repayment more attractive to small borrowers.

The Dominican Republic

Background on the Dominican Republic is useful in understanding why group lending emerged there and why it is a case worth studying. Twenty years ago it would have been difficult to predict a prosperous future for the Dominican Republic (Clausner). The country had been ruled for 30 years by a heavy-handed dictator, the economy depended mainly on sugar production for its export earnings, it had a rapid population growth rate, a very weak educational system, and very few trained technicians. The country had modest endowments of natural resources with much of the country too dry or too mountainous to support intensive agricultural production. The ownership by foreign corporations of some of the best lands and many of the mineral properties compounded the country's problems. A good deal of political instability and civil war in the mid-1960's further disrupted the country.

Relatively large amounts of foreign assistance and a good deal of self-help over the past 15 years have resulted in a surprising amount of economic progress. This has occurred even with several years of severe drought, unstable and often low sugar prices, hurricanes, and an epidemic of African swine fever that sharply reduced the country's swine herd. Despite these set-backs, the country has made steady economic progress and recently had an orderly transfer of government from one civilian president to another. With all of the current turmoil that exists in Central America and the Caribbean the Dominican Republic stands out as a bright spot.

While the country has made substantial progress it still faces a number of difficult problems that were compounded by two devastating hurricanes in 1979. These problems include a serious lack of inexpensive energy sources that can be used to substitute for increasingly costly imports of petroleum products. This, in turn, puts pressure on balance of payments and internal price stability. The country also imports a significant part of its food. Continued rapid population growth plus covert migration from Haiti continues to expand the amount and extent of poverty in urban areas and even more critically in rural areas.

Gradually over the past twenty years the country has developed a number of the elements needed to increase the pace of agricultural development. As a part of this, a good deal of effort has gone into expanding the number of institutions providing loans to agriculture, and to expanding the amount of money lent to farmers. About one-fifth of the farmers in the country now receive formal loans, but there are few formal savings deposit facilities readily available in rural areas.

As can be seen in Table 1, the Agricultural Bank along with commercial banks play a major role in providing agricultural loans. The commercial banks mainly service large farmers while the Agricultural Bank makes about half of its loans to

TABLE 1: New Agricultural Loans Granted by Formal Lenders in the Dominican Republic, 1961-1978a/ (Million Current Pesos)b/

Year	Total	Agricultural Bank	Commercial Banks c/	DDF d/	IDECOOP e/	Finan-cieras f/	Other g/
1961	7.0	3.3	3.7	-	-	-	-
1965	26.5	21.1	5.4	-	-	-	-
1966	33.3	20.8	12.2	-	.3	-	-
1967	36.3	22.3	13.3	.1	2.2	-	-
1968	42.5	25.0	15.2	.1	2.2	-	-
1969	42.3	28.0	12.7	.2	1.3	.1	-
1970	45.6	29.2	15.5	.2	.6	.1	-
1971	48.6	30.1	16.2	.4	.8	.8	.3
1972	55.2	31.5	21.1	.5	.9	[illegible]	.3
1973	81.3	43.4	34.5	.5	1.5	1.1	.3
1974	119.4	68.0	46.9	.8	.8	2.8	.1
1975	151.8	78.0	61.9	1.6	.8	9.4	.1
1976	152.3	81.4	61.9	2.3	.6	6.0	.1
1977	170.7	83.5	73.1	2.2	.5	11.3	.1
1978	192.9	111.9	67.4	2.9h/	0	10.[illegible]h/	.1

a/ Does not include loans which large agricultural firms may obtain outside the country.

b/ The official rate of exchange has been one peso per U.S. dollar throughout the period covered by this table.

c/ Banco Central de la Republica Dominicana, Boletin Mensual, various issues. Includes loan to Secretaria Estado de Agricultura for supervised credit program, and credit for land reform participants in Instituto Agrario Dominicano. Year-end outstanding balance figures instead of new loans made during the year.

d/ Fundacion Dominicana de Desarrollo, Boletin Estadistico, various issues.

e/ Instituto de Desarrollo y Credit Cooperativo, unpublished reports.

f/ Unpublished reports by various financieras.

g/ Unpublished reports of the Oficiana de Desarrollo de la Comunidad and CARITAS.

h/ Estimated by authors.

small and medium sized farmers along with land reform participants. The financiaras provide loans to large operations, while the Dominican Development Foundation (DDF) makes most of its loans to the rural poor. The expansion of agricultural credit in the country has been strongly supported by foreign aid agencies. Loans and grants for about 90 million dollars have come into the country the past 20 years for this purpose (Table 2).

As in most countries, formal agricultural loans carry concessionary interest rates. Currently the nominal interest rates on agricultural loans range from 8-12 percent per year, including service fees. In late 1979 commercial banks expected yields in other sectors in excess of 18 percent on well secured loans with customers who had excellent credit ratings. Until 5 or 6 years ago the nominal interest rates in the economy generally exceeded the annual changes in the consumer price index. Recently, however, rates of inflation have accelerated, and since 1974 have generally exceeded the nominal rate of interest charged on agricultural credit. Individuals have received negative real rates of interest on their savings deposits and those with easy access to formal credit have realized an income transfer through borrowing at negative real rates of interest.

Group Lending in the Dominican Republic

Several organizations in the Dominican Republic have experimented with group lending: the Oficina de Desarrollo de la Comunidad, the Comite de Ciudadanos, the Instituto de Desarrollo

TABLE 2: External Loans or Grants for Agricultural Credit in the Dominican Republic, 1960-79

Year	Foreign Agency[a/]	Local Agency	Amount of Loan or Grant -Million-	Terms	Objectives
1962	IDB	Agricultural Bank	$ 3.0 U.S.	20 ys. 1-1/4%	Ag. Credit
1963	IDB	Agricultural Bank	4.9 U.S. 1.1 R.D.	12 ys. 5-3/4%	Livestock
1966	PADF	DDF	.5 U.S.	Grant	S.F. Credit
1966	AID	Agricultural Bank	9.5 U.S.	40 ys. 2-1/2%	Ag. Credit
1968	AID	IDECOOP	2.6 U.S.	40 ys. 2-1/2%	Coop. Credit
1969	PDAF	DDF	.3 U.S.	20 ys.	Group Credit
1971	IBRD	C.B. (FIDE)	5.0 U.S.	50 ys. 3.5%	Livestock
1972	IAF	DDF	.5 U.S.	Grant	Group Credit
1972	IDB	Agricultural Bank	16.8 U.S. 8.0 U.S.	40 ys. 1-1/4%	Ag. Credit
1973	IDB	IDECOOP	1.6 U.S.	----	Fishery
1974	AID	SEA, DDF & Agricultural Bank	9.0 U.S.	40 ys. 3%	Ag. Credit
1976	AID	SEA & Agricultural Bank	7.0 U.S.	40 ys. 3%	Ag. Credit
1976	IDB	Agricultural Bank	16.0 U.S. 3.5 D.R.	40 ys. 2%	Ag. Credit
1978	IAF	FICOOP	.5 U.S.	----	Ag. Credit
		Total	$89.8		

a/ Inter-American Development Bank (IDB), Agency for International Development (AID), Pan American Development Foundation (PDAF), World Bank (IBRD), Inter-American Foundation (IAF), Dominican Development Foundation (DDF), Instituto de Desarrollo y Credito Cogperativo (IDECOOP), Central Bank (CB), Secretaria Estado do Agricultica (SEA), Financiera Para El Desarrolla y La Cooperativa (FICOOP).

y Credit Cooperative, several commercial banks and DDF. Some of these group lending programs have grown out of community development activities by various government agencies or through church efforts. Still other groups were formed by lending agencies. A tradition of informal groups of farmers working together to do joint tasks through convites provided some social basis for the formation of these groups. The san, an informal rotating savings credit association found throughout the country, also provides a traditional basis for informal groups among the poor (Norvell and Wehrly).

While DDF has other development activities, loans to groups of small farmers make up a large part of its total efforts. DDF was one of the first organizations to become involved with group lending, and currently has the largest program of this type in the country. DDF's lending activities are interesting because they deal strictly with the poor, and because of the innovations involved. The roots of DDF go back to the Alliance for Progress initiated in the early 1960s and private sector interests in the Dominican Republic that felt more should be done about rural poverty. In its current form, DDF was legally organized in 1966 as a non-profit organization. Initially, a good deal of its funding came from private gifts, corporation donations, and grants from foreign foundations. As its lending activities have grown, it has relied heavily on loans and grants from commercial banks, government agencies, and international aid agencies.

The main aim of DDF is to promote social and economic development among the low income people in rural areas (Freire). It is a relatively small organization that works in seven regions of the country. Its board of directors includes individuals who have had, or currently hold, prominent positions in the government and private business. The leaders of the Foundation are highly motivated and have a sincere interest in helping the rural poor.

While DDF does a significant part of the total lending to the rural poor, its loans make up only a small part of all money lent to agriculture. Overall, DDF handles about 2 percent of the total value of new loans each year to agriculture. As can be noted in Table 3, recently DDF has made loans through groups to about three or four thousand small farmers. Most of these farmers do not have access to other formal sources of credit. The loan portfolio of DDF grew steadily from only about .1 million pesos in 1966-67 to about 6.3 million pesos in 1978-79, while the value of new loans made each year increased from about .1 million to 1.6 million.[2/] The past several years DDF has found it difficult to find additional funds, nevertheless, to maintain or expand its volume of lending. During this period there has been a rise and fall in the numbers of groups and individuals participating. A high point in number of groups and individuals was reached in 1973-74 when loans were made to

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2/ The official rate of exchange has been one pesos per dollar for many years. The parallel market rate gives a 15-20 percent premium to the dollar.

TABLE 3: Growth in DDF Portfolio and Lending Activities, 1966-79

Year	Portfolio[a/] RD($)	Number of Groups	New Loans Made During Years[b/] RD($)	Individuals	Average Loan Size per Group	Average Loan Size per Individual RD$
1966-67	106,829	42	117,670	2,081	2,802	57
1967-68	224,541	161	216,682	2,167	1,346	100
1969-70	376,770	160	234,822	4,461	1,468	53
1970-71	583,004	156	387,682	4,954	2,485	78
1971-72	836,990	257	480,264	5,726	1,869	84
1972-73	1,121,557	198	455,277	4,457	2,299	102
1973-74	1,712,880	393	550,172	6,923	1,400	112
1974-75	2,481,213	248	1,758,284	5,150	7,090	396
1975-76	3,512,307	231	2,396,142	4,440	10,373	499
1976-77	4,512,961	189	2,282,895	4,029	12,079	567
1977-78	5,604,726	212	2,888,244	4,668	13,624	619
1978-79	6,323,120	124	1,602,831	2,590	12,926	619

Source: Dominican Development Foundation, Informe Anual, 1979.

a/ Year End Balance, June 30. The official rate of exchange has been one peso for one dollar throughout the period covered by this table.

b/ Based on fiscal year July 1-June 30.

about 400 groups with almost 7 thousand members. Since that time both numbers have declined sharply to only 124 groups and 2,590 individuals in 1978-79. This reduction from 1975 to 1979 in the numbers of groups and individuals serviced occurred despite a more than six-fold increase in the total loan portfolio of DDF, and a two-fold increase in the value of new loans made yearly.

Compared to other agencies trying to provide financial services to the poor, DDF has been quite innovative. For example, they have blended private, corporate, government, and foreign aid agency interest into their activities. This has allowed them to draw political as well as financial support from a broad range of sources. It has also resulted in DDF pulling influential people into their program. While DDF's activities were largely initiated on grants and gifts, they have been able on occasion to gain access to regular financial sources to support some of their lending programs. They have also been quick to adopt new management tools such as computers, and have been able to maintain staff esprit de corps despite modest salaries. It was also one of the first organizations in the world to experiment on a large scale with group lending and has been quite dynamic in making various adjustments that were aimed at expanding and improving the effectiveness of group lending. As will be discussed later, DDF also has experimented with a loan guarantee program aimed at inducing commercial banks to service the rural poor. While doing this, DDF has been able to maintain a positive image among the influential, the rural poor and international donors and aid agencies - no small task in a world where "social minded" agencies often turn up with poor press a few years after they begin operations.

The Mechanics of Group Lending

As mentioned earlier, some groups have been in existence for several years before they approach DDF for a loan. Other groups are drawn together by DDF coordinators. The group may vary in size from 10 to more than 100 individuals. Once a group is formed or makes contact with the coordinator, a meeting is held with group members and DDF's program is explained. If the coordinator feels that the group is serious about working together, additional meetings are held. A coordinator may meet regularly with a new group for a number of months to help design a loanable project. This may include short courses for all or part of the members in production techniques critical to the success of the proposed project. This proving and training period is costly for DDF, especially if the groups are newly formed. During the formation period the group elects several leaders to represent it in loan negotiations. These leaders also work with the DDF coordinator in preparing a project plan on which a loan is justified.

Each loan is aimed at a specific production activity. The project, for example, might be to help finance rice production on land that is owned or rented by group members. Not all members of the group need be participants at any one time in the project and loan, however. Typically, the members purchase inputs with the loan and apply them to their own individual enterprises. Members of the group may, in addition, exchange labor informally in planting and harvesting.

The loan transaction is handled for DDF by any bank located in the vicinity. The DDF transfers funds to the bank, who in turn issues a check in the name of the group leader. This check is deposited in a savings account and withdrawals are made as needed by the group with the signatures of the group leaders. The secretary of the group is responsible for maintaining records on who receives portions of the loan and also their repayment. In all cases the members of the group who participate in the loan agree to be jointly liable for repayment of the entire group loan. This agreement is not legally binding, however, because the informal groups are not legally recognized entities in the Dominican Republic. In the case of a loan default the DDF only has legal recourse against individual borrowers within the group. DDF has collection agents who work on recovering loans from individuals who were in groups that have disbanded, or from individuals who have failed to repay in on-going groups.

Evaluation of Group Lending Practices

A recent study in one of the seven areas where DDF is working illustrates some of the strengths and weaknesses of DDF's group lending (Pablo). This study was carried out in late 1978 in the Bonao region, a rice area located in the central part of the country. Bonao was one of the first regions where DDF started making group loans. DDF's program there is neither its best nor its worst. The study focused on examining the benefits and costs of group lending. It showed that there had been a good deal of instability in the number of groups receiving loans in the area. From 1966 to 1978 DDF made 244 separate loans to 63 groups of farmers in Bonao. In late 1978 only 23 groups were still active and receiving loans from DDF. Several of the groups had disbanded because they lost interest in working as a group and getting a loan from DDF. Other groups had disbanded and did not repay their loan. Still other groups were combined to form larger groups in order to reduce DDF's costs of administration.

While the reaons for group failure varied, several reasons were common. Those groups formed mainly for the purpose of getting access to a DDF loan tended not to last very long. It appears that group cohesion grew out of individuals realizing "group goods" in addition to just access to credit. As might be expected, loans made to groups that had been together for some time prior to getting a DDF loan tended to have higher loan repayment rates and continued existence. The fact that the individuals hung together as a group prior to getting a DDF loan strongly suggests that individuals were realizing "group goods" besides just access to DDF loans. It was also noted that groups that contributed a significant part of the resources that went into the project funded by the loan tended to have higher repayment performance than those groups that used the loan to cover most project expenses. A number of groups in one area had disbanded and failed to repay their loans. Many of the people living there were recent migrants and had not developed social ties beyond the loan to bind them together.

An analysis of the costs of lending to groups versus loans to individuals was not possible because DDF only makes group loans. It appeared, however, that there is a clear trade-off between keeping group lending costs down, and helping to create, reinforce, and provide technical assistance to groups. Some of DDF's groups were already formed and had group cohesion before DDF came on the scene. Some of the groups, however, were formed by DDF. In some cases, DDF works with a newly formed group for up to 6 months to make sure that it was reasonably viable before making a loan. Group formation and supervision costs were very substantial where on-going groups did not already exist. The fact that groups do not provide loan collateral also raises the expected lender costs of trying to collect delinquent loans. Despite these qualifications, it was clear that lending to groups involved less lender transaction costs per unit of money lent than would individual loans to group members. At the same time, it is obviously more expensive for the lender to service groups than it would be to lend the same amounts to more prosperous individuals who could provide secure collateral for their loans. A recent analysis of DDF's lending activities showed that the cost of lending, forming and supervising the groups amounted to about 20 percent of the value lent (Roach).

The effectiveness of joint liability in encouraging loan repayment was also not clear cut. Some well established groups maintain informal vigilante committees that, in extreme cases, may take the law into their own hands and extract a piece of property from the delinquent member to cover unpaid loans. This type of social sanction appears to work best when the members in good standing in the group feel they lose a lot if the group does not meet its loan obligations. The quality of the loan service provided is an important factor in this. If the group has only been formed to get access to the loan, the group feels hasseled in getting the loan, and the loan arrives late, group sanctions to reinforce repayment appear to be very weak.

As with lender costs, it was difficult to get strictly comparable costs of an individual borrowing through a group versus obtaining an individual loan from a formal lender. Almost none of the DDF group borrowers get individual loans from other formal lenders. To shed some light on this question, an analysis of total borrower loan transaction cost of a ten member DDF group was made. This was compared with similar cost incurred by 10 individual small borrowers from the National Agricultural Bank in the same region. The transaction costs included the opportunity costs of time taken to negotiate the loan, interest payments and service fees, travel costs, and costs of borrowing short term in the informal market to cover expenses because of delays caused by late formal loan disbursement. The interest and service fee charges were identical for DDF and the Agricultural Bank. Both the group and the individual borrowers were often forced to borrow money in the informal market to cover their production expenses because the DDF and the Agricultural Bank disbursed their loans 30-60 days after the farmers incurred a major part of their production expenses. Because the group loans were largely negotiated by only one or two of the group leaders, the group members lost less work time and had to spend less on travel expenses than did individual borrowers. Overall, the group incurred loan transaction costs that were about 20 percent lower than did the 10 individual borrowers for equal amounts of money. At the same time, individuals gave up some of their freedom by being in a group. Whether this saving in loan transaction costs would have been sufficient to induce them to participate in a group loan, over an individual loan, cannot be answered because members of the group had little access to formal loans outside of group participation.

Almost everyone contacted in the study agreed that providing technical assistance to the group was both more cost effective and easier than trying to do it with individuals.

Loan Guarantee Program

One of the most interesting innovations tried by DDF was a guarantee program aimed at inducing commercial banks to lend to groups graduated from DDF's own lending program. Leaders in the Foundation realized in the early 1970s that they must tap regular financial channels to service additional rural poor. In 1972, DDF received a grant from the Inter-American Foundation for about a half million dollars to initiate this guarantee effort.

The thinking behind the program was that DDF would provide the commercial banks with credit references on the groups, continue to provide technical services to support the activities financed by the commercial loan, and also offer the bank a loan guarantee to cover part of any default: 75 percent of the amount lent the first year to the group, 50 percent the second year, and 25 percent the third year. It was hoped that the loan guarantee along with the other DDF services of identifying and supervising the groups would provide commercial lenders with enough additional incentives to lend to the rural poor. The intent was for DDF to obtain leverage through the use of grant funds to guarantee a much larger amount of money lent to groups by commercial lenders.

The terms of the loans made by the banks to the groups were those generally used by the DDF and the Agricultural Bank. The loans carried an interest rate of 8 percent, plus a 2 percent service charge fee. The commercial banks were able to increase their effective yields on these group loans to about 11 percent by deducting the interest payment and service fee in advance from the principal lent to the groups. In 1973 when the guaranteed loans were first made by commercial banks, the expected yields from well secured commercial loans ranged from 11 to 13 percent. By deducing interest in advance, charging 10 percent, relying on DDF to cover some lending costs, and having a loan guarantee for 75 percent of the loan value, banks in 1973 expected returns from group loans approximately equal to those they could realize from other loans. Furthermore, DDF had several members on its board of directors from the banking community who were able to encourage important banks to go out of their way to promote a worthy cause. In 1973, four major banks began to make loans to groups under the guarantee program. Two of these banks were foreign owned and their participation may have been related to public relations. The number of groups served under the guarantee program expanded rapidly in 1973-74 but then tailed off and by 1978 no commercial bank was willing to participate. This occurred despite the fact that repayment rates had been excellent and DDF was called upon to pay for only a small amount of defaulted loans out of guarantee funds.

A total of 220 loans were provided for a total of almost 2 million pesos under this program of guarantees during the 1973-77 period.

Various explanations have been offered for why this very interesting and promising innovation started with a bang, yet failed. It appears that both DDF and the banks lost interest in continuing the guarantee program. DDF's enthusiasm waned because it continued to incur significant costs to help its best groups prepare loan proposals for bank funding. DDF also incurred expenses to supervise the loans and help in loan recovery. Since the banks kept all of the interest payment, DDF received no revenue to off-set their costs of serving loans made under the guarantee program.

Bankers mentioned a number of reasons for pulling out of the program. Some mention the declining portion of the loan principal covered by the guarantee as being a factor. Others suggest that droughts during the mid-1970s in the country made it more risky to lend to agriculture and especially to those borrowers without adequate collateral. Still others argue that these types of group loans cost them more to administer than they had expected. Also during the period 1972-78, DDF began to experience more difficulties overall in maintaining high repayment records among its groups. This made the credit worthiness of DDF's portfolio less attractive to commercial lenders.

Other less well recognized forces were also at work that caused commercial banks to back away from the group lending. In 1973 the rate of inflation in the country began to accelerate. Prior to this time, the nominal rates of interest paid on agricultural loans generally exceeded the rates of inflation, and positive real rates of interest were in force. Since 1973, however, the rates of inflation have generally exceeded the nominal rates of interest on agricultural loans. This has resulted in excess demand for these negatively priced loans, and has caused banks to severely ration these cheap loans away from the rural poor. Further, the opportunity cost of money lent at concessionary rates to agriculture has gone up substantially. As mentioned earlier, the effective yield on commercial loans moved up to exceed 18 percent the past several years. It appears that banks were willing to participate in a program that may have been only marginally profitable to them initially, but with an increase in inflation and a jump in returns that could be realized from loans to other sectors, the banks made a profit maximizing decision that pushed the rural poor and the DDF aside.

It is doubtful if even a steady guarantee of 100 percent would have convinced the banks to continue lending to groups at effective yields of about 11 percent when they could get 18 percent on their loanable funds, at lower loan transaction costs per unit of money lent, by shifting all their funds to traditional clients. In this case, interest rate regulations kept costs of formal credit down for the rural poor, but formal lenders were unwilling, and DDF unable to provide loans at these prices. This forced the rural poor to go to informal lenders who charged higher rates and/or to do without additional formal loans.

Conclusions

Despite a number of substantial accomplishments, DDF is faced with some very tough problems. As might be expected, individuals, corporations, and foreign foundations are not interested in indefinitely supporting an agency. Foundations, especially, like to view their grants as seed money that will flower into a self-perpetuating perennial. While DDF has been highly successful in attracting grants from foundations, these foundations generally only want to give DDF one or two grants. DDF has been able, with difficulties, to draw funds from regular financial channels, but these sources of loans look carefully at DDF's balance sheet, may have strong political overtones or demand that their revenue exceed their costs for the loan.

At least two major factors make it difficult for DDF to become a regular part of the financial community. The first is the DDF has incurred some repayment problems among its groups. In the initial stages of DDF's group lending program, they reported excellent repayment performance. In recent years, however, a higher proportion of DDFs loans are not repaid, or are repaid late. Part of this deterioration in repayment performance is due to debt refinancing in the early part of DDF's program that made repayment appear to be better than in fact it was. That is, DDF refinanced loans to certain groups that were unable or unwilling to repay loans and these did not appear as repayment problems until several years later when DDF finally decided not to refinance the group. Secondly it is also apparent that the quality of loan services provided by DDF has not improved over the past few years. DDF has been forced to economize on the amount of technical assistance and supervision that it gives groups. Fewer groups and fewer total people serviced were parts of this change. Even more important, because of repayment problems, erosion of the purchasing power of DDF's loan portfolio by inflation, and their difficulties in getting access to additional loanable funds, DDF does not have enough funds to meet loan demand among its groups. This has resulted in loan disbursements to groups arriving up to several months after crops are planted. This forces the group to rely on informal lenders for several months to fund the part of their activities covered by DDF loans. The added cost of borrowing from the informal market, and the late arrival of DDF loans, has caused borrowers to feel that the quality of DDF's loan services has deteriorated. As a result, some groups delay repaying a loan so that they can finance their next crop. Other groups or individuals may default altogether on their loans because they feel that maintaining a good credit rating with an agency that is becoming less able to supply their financial need is not worth all that much. Said another way, it may be that a good credit rating with DDF is worth less now than it was a few years ago because the quality of DDF's financial services has declined.

It is surprising how many organizations like DDF start with a flourish, receive a number of grants to start their program, show very promising initial results, but then run into rough water about the time that grant agencies decide they want the agency to stand on its own feet. In large part these problems can be explained by simple comparison of costs and revenues. Basically, DDF has a program that is costing it 20 cents or more of every peso lent to run while they are only charging 10 cents for every peso lent. Without a continual inflow of grants or subsidies amounting to at least 10 percent of their loan portfolio they cannot maintain the nominal value of their loanable funds. This assumes that they recover most of their loans. If the loan default amounts to 10 percent per year, other things being equal, DDF's loan portfolio will essentially evaporate in about 5 years. If the rate of inflation is significantly greater than the nominal rate of interest rate, which it currently is in the Dominican Republic, the purchasing power of the loan portfolio will erode even more quickly. Without an outside subsidy on a regular basis, DDF cannot present a strong financial statement to potential funding agencies.

Despite the aggressive and innovative beginnings of DDF, it has not been able to develop innovations in financial intermediation that would allow it to service the financial needs of the rural poor, to maintain its own financial viability, and at the same time charge only 10 percent for its services. The agency is trying to provide a service at a price that will not cover its costs. Our opinion is that they have been running a lean shop and have kept their costs about as low as one could expect. To further reduce the average cost of lending would probably reduce the quality of DDF's services and further erode the incentives that borrowers have to maintain good credit ratings with the agency. The concessionary interest rate policies that so many countries insist on pursuing may be a major factor that causes many financial innovations to end up stunted or abort. Many of the innovations may be cost decreasing, but they do not decrease cost enough to allow agencies to sustain themselves with cheap interest rate policies.

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